Clauses Under Del. Law

Barry M. Klayman and Mark E. Felger, Delaware Business Court Insider
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Agreements, especially acquisition agreements, typically contain representations and warranties by one party to the other. The agreements also typically prescribe the duration of those representations and warranties in so-called survival clauses. The treatment of these clauses under Delaware law may surprise many practitioners. In *GRT v. Marathon GTF Technology Ltd*., C.A. No. 5571-CS (Del. Ch. Jul. 11, 2011), Delaware Chancery Court Chancellor Leo E. Strine Jr. held that a clause limiting the period of time in which contractual representations and warranties survive closing acts as a statute of limitations on the buyer's ability to commence litigation for breach.

The facts of the case were not unusual. The parties entered into a series of contracts in order to form a joint venture to promote a new technology. GRT granted a license to use certain of its intellectual property in exchange for access to a demonstration facility that had been designed but was still under construction by Marathon and which Marathon represented would meet certain design objectives. The contract provided that the design representations "will survive for 12 months after the closing date, and will thereafter terminate, together with any associated right of indemnification [under certain provisions of the contract] or the remedies provided [in certain provisions of the contract]." The contract provided that other representations would survive the closing indefinitely or would survive until the expiration of the applicable statutes of limitations.

GRT was permitted to inspect the demonstration facility after closing. During the survival period, GRT informed Marathon that the demonstration facility did not meet the design representations, but it did not sue for breach of the design representations until after the expiration of the survival period.

Marathon moved to dismiss the claim for breach of the design representations, arguing that the contract shortened the three-year statute of limitations applicable to breach of contract claims to

one year because the design representations, as well as the contractual remedy for any breach of the representations, expired at the end of the survival period. GRT argued that the survival clause should not be read to shorten the time in which a claim of breach must be brought, only to shorten the period in which a breach may occur subject to the ordinarily applicable three-year statute of limitations.

The court held that any claim for breach of the design representations had to be brought before the survival period expired. First, the court pointed to the plain language of the survival clause, which was drafted in "liability-limiting fashion." It contrasted the survival period for the design representations with the survival periods for other representations in the contract. Second, the court pointed to Delaware precedent, which is "more contractarian" than that of many other states, respects the parties' contractual choices, and does not impose any special rule requiring the parties to utilize "clear and explicit" language in order to shorten the statute of limitations as some other states do. Third, the court pointed to learned commentary and treatises that conclude that a survival clause with a discrete survival period has the effect of granting the nonrepresenting and warranting party a limited period of time in which to file a post-closing lawsuit.

In so doing, the court distinguished those commentaries that were descriptive in nature, which attempt to explain what transactional lawyers have traditionally meant when using survival clauses, from those commentaries that were prescriptive in nature, which attempt to advocate for practices that they view as preferable. Finally, the court pointed to the business context of the contract, noting that the parties were involved in a highly experimental industry involving commercialization of new technologies where time is of the essence and change is rapid. The court found that it was not plausible that the parties intended the survival clause to give GRT four years after the closing to bring suit for breach of the design representations.

The *GRT* decision represents the court's view of the proper interpretation of the language used by the parties in their contract. It is fair to ask whether the decision is sui generis. How much weight should be given to the fact that the survival clause not only limited the duration of the design representations, but also expressly limited the duration of the indemnity obligation and the remedies for breach of the design representations?

These questions were recently answered in *ENI Holdings v. KBR Group Holdings,* C.A. No. 8075-VCG (Del. Ch. Nov. 27, 2013), which held that parties to a stock purchase agreement may contractually agree to a period of limitations shorter than that provided by statute, as long as the shortened period is reasonable, and by drafting a survival clause, which states that representations and warranties survive only through a specified date, and they evidenced an intent to shorten the period of time in which a claim for breach of those representations and warranties may be brought.

KBR argued that, unlike in *GRT*, the contractual language at issue was silent as to the termination of the remedies for any breach. Vice Chancellor Sam Glasscock III rejected that argument, finding that while the simultaneous expiration of representations and their remedies "bolstered" the court's finding in the *GRT* case, it did not provide the basis for the court's holding

that "a period of survival of representations and warranties, followed by a date of termination, limited actions to the survival period only."

KBR also argued that the intraparty dispute resolution scheme in the contract, requiring the parties to attempt to resolve any dispute extrajudicially, was inconsistent with the survival clause creating a limitations period. KBR argued that it was unrealistic for the parties to contemplate that suit would be commenced during the survival period given the dispute resolution provisions in the contract. Glasscock rejected this argument, too, stating that it was not a reasonable interpretation of the contract that KBR could preserve a lawsuit based on an expired representation or warranty merely by giving notice before the applicable termination date. "This is neither how a statutory limitations period nor a contractual limitations period operates under Delaware law," the court held.

Finally, KBR argued that in negotiations and court filings, ENI did not argue that KBR had to file suit within the survival period to preserve its claim, and this indicated the parties' intent that KBR only had to serve notice of the breach before the termination date rather than file a lawsuit to preserve the claim. However, the court refused to consider these communications as extrinsic evidence of the parties' intent, since it found the language of the contract to be clear and unambiguous.

What lessons do we take away from these cases? As a matter of contract interpretation, without more, a clause limiting the period of time in which contractual representations and warranties survive closing has the effect of granting the nonrepresenting and warranting party a limited time in which to file a suit for breach of those representations and warranties. When the representations and warranties terminate, no suit for breach can be maintained. The result will not change even if the contract provides dispute resolution procedures that must be followed before suit can be commenced and that may extend beyond the survival period. Finally, the nonrepresenting and warranting party will not be allowed to introduce extrinsic evidence to suggest that the parties intended a different result, since the survival language, without more, is clear and unambiguous.

Can the contracting parties avoid the holdings of these cases? Since the outcome in both cases purports to be based on the parties' intent as expressed in the clear and unambiguous language of their contract, the parties should be able to expressly state whether they intend the survival language to create a limitations period or to merely require notice of a breach, with some other period specified for bringing suit. This, however, has not been the practice of transactional attorneys when drafting these types of contracts, nor is it reflected in the language of most sample agreement forms. These cases suggest the need to review and reconsider the language found in the standard survival clause, especially if Delaware law will control the interpretation of the contract.

Barry M. Klayman *is a member in the commercial litigation group and the bankruptcy, insolvency and restructuring practice group at Cozen O'Connor. He regularly appears in Chancery Court.*

Mark E. Felger *is co-chair of the bankruptcy, insolvency and restructuring practice group at the firm.*